Statutory Accounting Principles (E) Working Group
2022 Spring National Meeting
Comment Letters Received

TABLE OF CONTENTS

D. Keith Bell, CPA
Senior Vice President
Accounting Policy
Corporate Finance
The Travelers Companies, Inc.
Phone : 860-277-0537
Email: d.keith.bell@travelers.com

Rose Albrizio, CPA
Vice President
Accounting Practices
Equitable
Phone: 201-743-7221
Email: rosemarie.albrizio@equitable.com

February 18, 2022

Mr. Dale Bruggeman, Chairman
Statutory Accounting Principles Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Items Exposed for Comment by the Statutory Accounting Principles Working Group on December 11, 2021 with Comments due February 18

Dear Mr. Bruggeman:

Interested parties appreciate the opportunity to comment on the exposure drafts released for comment by the NAIC Statutory Accounting Principles (E) Working Group (the Working Group).

We offer the following comments:

Ref #2019-21: Proposed Bond Definition

Pursuant to the direction from the Working Group in October 2020, a small group of regulators and industry have been meeting regularly to draft a bond definition for consideration. The intent of this project is to clarify what should be considered a bond (whether captured in SSAP No. 26R—Bonds or SSAP No. 43R—Loan-Backed and Structured Securities) and reported on Schedule D-1: Long-Term Bonds. This exposure is specific to the proposed bond definition included in the exposed Form A, along with the glossary (page 5) and appendices (pages 6-12), but comments on future developments (such as reporting changes, accounting and reporting guidance for items that do not qualify as bonds, transition guidance, etc.) may also be submitted to assist in the development of these items.

Interested parties appreciate the collaborative effort, between NAIC staff, regulators and interested parties, on this significant and complex project. We note this exposure includes the following three separate and distinct components for which we will provide comments:

1) Sufficiency Discussion – Concept (Attachment N),

2) Sufficiency Discussion – Examples (Attachment N-1),
3) Reporting Options (Attachment M).

Interested parties are supportive of the proposed refinements to the sufficient credit enhancement concept. Interested parties believe the clear articulation of the intent of the required substantive credit enhancement provides for a more understandable and workable proposed bond definition. Likewise, interested parties are supportive of the revised examples, where the new substantive credit enhancement concept has been incorporated.

Interested parties also offer the following comments on the various possible reporting options for Schedule D-1.

1. **Reporting Lines:**

With the principles-based bond definition, it is recommended that more granular reporting lines be established to capture investments in scope of SSAP No. 26R and SSAP No. 43R. From preliminary assessments, the current general categories are not used for analytical assessments / reports except for U.S. Govt – Full Faith and Credit. As such, this document proposes to replace the current general categories with the inclusion of more useful reporting lines based on the type of investment.

Exposure Request Detail provided on pages 2-5:

1. Information is requested on the potential removal of the general categories and whether the elimination would impact any tools or analyses currently performed.
    - Interested parties have no concerns currently with the proposed removal of the general categories.

2. Information is requested on the proposed reporting lines and whether additional categories would be beneficial. (Note – The proposal suggests dedicated reporting lines for certain securities that are now identified by codes. Comments on this approach are requested.)

    - Interested parties note that one of the challenges with the current Schedule D reporting categories and/or columns is ambiguity which leads to inconsistent reporting among companies. Interested parties recommends working together to ensure the instructions are clear and unambiguous to help prevent this problem with the new reporting schedules. This will benefit both companies and regulators.
    - Interested parties would like a better understanding of the unaffiliated/affiliated split of certain rows in the proposal; for example, are the rows not labelled with ‘Affiliated’ implied to be ‘Unaffiliated’? Or are the affiliated rows a subset of the former? Have you considered an alternative such as removing the lines identifying ‘Affiliated’ investments and utilizing a column to identify them instead? Blanks interested parties are suggesting that an Affiliated or Related Party indicator be utilized in a column for the investment schedules in the Blanks exposure 2021-22BWG (Related Party Reporting).

- Since investments in GNMA are RBC exempt, we recommend that additional lines be added to the ABS section to accommodate these for ease of identification (e.g., US Government Residential Mortgage-Backed Securities; US Government Commercial Mortgage-Backed Securities).
- Consider adding a new category in Issuer Credit Obligation for investments in Surplus Notes/Surplus Debentures which are currently reported on Schedule BA.

2. **New Sub-Schedule D-1**:

The bond project is currently proposing a new sub-schedule that details bond investments that have certain characteristics (e.g., ABS backed by financial assets that are not self-liquidating and ABS backed by cash-generating non-financial assets not captured within the practical expedient.)

Exposure Request:

1. Information is requested on how investments shall be categorized on this schedule.
    - Interested parties believe that the proposed 'sub-schedule' for Schedule D – Part 1 could be confusing, and the proposed data could be readily incorporated into electronic-only columns for the respective categories in the 'Other Asset-Backed Securities' section.
    - Clear instructions for each category under Other ABS will be extremely beneficial.
2. Information is requested on additional information / columns desired for these structures. Initial ideas that have been proposed include:
    a. Balloon payment as % of principal at acquisition
    b. Current loan-to-value
    c. PIK – Information on whether payment of interest is deferrable
    d. Amount of PIK interest to date
    e. Expected payoff date determined at acquisition
    f. Expected payoff date as of the financial statement date.

    - Currently, interested parties would support the proposed data elements for the 'Other Asset-Backed Securities' categories being reported in columns instead of in a 'sub-schedule'. As changes to SSAP No. 26R and SSAP No. 43R are finalized for this project and further evaluation of these investments is done, modifications to the list may be warranted.
    - Interested Parties note that some of this data (e.g., Expected payoff date determined at acquisition) may not be readily available upon transition because it assumes a forward-looking analysis at a point in time that has already occurred (potentially decades in the past). Would a practical expedient be needed upon adoption to populate these types of fields?

3. **Schedule D-1 Information**:

As noted, with the change in reporting lines, it has been proposed a review of the columns and instructions also be considered. The following code columns have been potentially identified.

- Column 3 – Code Column
- Column 5 – Bond Characteristics
- Column 26 – Collateral Type
- Column 34 – Capital Structure Code

Exposure Request– Detail provided on page 6:

1. Information is requested on whether other columns / reporting instructions should be clarified as part of the bond proposal project.
   - Interested parties are requesting additional time to address possible changes to the definitions of the columns indicated in the proposal. As rows are being changed, it could have a direct impact on what might be included in the columns as to minimize data redundancy.
2. Comments are welcome on the additional investment elements should be captured and/or whether certain elements are no longer beneficial to be captured. Potential elements related to asset-backed securities include:

   a. Market Validation – This will be a code to identify situations where none of the issuance is owned by unrelated parties.

   - Currently, interested parties don't have an issue with adding this field and we believe the answer could be either yes or no.
   - However, interested parties are not sure if the intent is to have the same meaning as the following – *This will be a code to identify situations where all of the issuance is owned by related parties*. If so, interested parties recommends removing the double negatives to be less confusing. If not, interested parties may not fully appreciate what is trying to be captured.

   b. Participation in residual tranche (Y/N)

   - Interested parties aren't sure how to respond to this question. Should the insurer respond Yes if it currently owns a residual tranche of the same securitization (e.g., residual issued from the same vehicle that issued the bond it invested in) or if they have ever owned a participation in the residual tranche?

Ref #2021-20: Effective Derivatives – ASU 2017-12

The Working Group moved this agenda item to the active listing, categorized as substantive, and directed NAIC staff to work with regulators and industry in assessing and developing revisions to facilitate effective hedge assessments consistently between U.S. GAAP and statutory accounting.

ASU 2017-12 provided targeted improvements to the existing GAAP hedge accounting framework that helps reduce some of the cost and complexity of applying hedge accounting and allows for additional hedging strategies that better align with an entity's risk management practices. Substantive changes that weren't initially adopted in SSAP No. 86 are addressing cross-currency basis spread as an excluded component, partial-term hedging for fair value hedges, ability to use the benchmark interest rate component of contractual cash flows to calculate the change in fair value of the hedged item in fair value hedges, last-of-layer/portfolio layer method for fair value hedges, and hedges of interest rate risk when the hedged item can be settled before scheduled maturity. Additionally, we are proposing clarifications to existing SSAP No. 86 for the accounting of forward points as an excluded component for currency forwards. Please refer to the attached appendix for proposed mark-ups to SSAP86 for these changes.

Summary of changes proposed to SSAP No. 86:

1. **Clarifications for the accounting of forward points as an excluded component for FX forwards –** Currently there is implicit inconsistency between paragraph 40 and Exhibit C for forward points as excluded components; this results in accounting that doesn't align with companies' risk management strategies. Application of the guidance in Paragraph 40 for a FX forward in an effective hedge relationship with an excluded component results in an impact to Surplus that is the same as ~~of~~ if hedge accounting had not been applied. We propose resolving this matter by explicitly allowing the guidance in Exhibit C to be applied regardless of whether a component of the derivative is excluded from the assessment of effectiveness. When forward points are an excluded component from the assessment of hedge effectiveness, the forward points would be amortized into income. This would allow for the execution of FX forward effective hedge relationships, which interested parties would consider sound risk management strategies, to receive an accounting treatment that is more favorable relative to hedge accounting not being applied.
2. **Adding cross-currency basis spread as an excluded component –** We propose adding cross-currency basis spread as an excluded component. Doing so better aligns hedge accounting with companies' risk management strategies, aligns the accounting for FX swaps where the cross-currency basis spread is an excluded component with the proposed accounting for FX forwards where forward points are an excluded component, and brings consistency between U.S. GAAP and Statutory accounting. Changes in the fair value of cross-currency basis spread have historically resulted in a less effective hedge or ineffective hedge because there is no corresponding offset in the hedged item. Excluding the cross-currency basis spread from the assessment of hedge effectiveness is beneficial for fair value hedges of foreign-denominated assets and liabilities. When the value of the cross-currency basis spread is excluded from the assessment of effectiveness, based on proposed changes to Paragraph 40 and Exhibit C, the excluded component would be held at amortized cost. With FX forwards, forward points as excluded components need to be amortized to be recognized in income. For FX swaps, the value of the cross-currency basis spread is embedded in the coupon payments of the swap, so the value is recorded in income each period through the typical swap accrual process.
3. **Adding ability to designate partial-term for fair value hedges –** We propose adding partial-term hedging for fair value hedges because it better aligns hedge accounting with companies' risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and Statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item must be used to

calculate the change in the hedged item's fair value attributed to the benchmark interest rate. With partial term an entity may designate only certain consecutive interest payments of a financial instrument as the hedged item and assume that the principal payment occurs at the end of the hedge term. Partial-term hedging allows entities to calculate the change in the fair value of the hedged item using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. When using full contractual cash flows to calculate the change in the hedged item's fair value attributed to changes in the benchmark rate, it can be difficult to achieve a highly effective hedge because the hedging instrument and the hedged item would react differently to changes in interest rates since the principal repayment occurs on different dates.

4. **Adding alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges –** We propose adding an alternative to use the benchmark interest rate component of contractual cash flows to calculate the change in the fair value of the hedged item in fair value hedges because it better aligns hedge accounting with companies' risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Currently SSAP No. 86 requires that the full contractual cash flows of the entire hedged item be used to calculate the change in the hedged item's fair value attributed to the benchmark interest rate. Calculating the change in fair value using only the benchmark rate component instead of the entire coupon may better reflect how an entity manages interest rate risk. In addition, it will provide a greater degree of offset between the changes in the fair values of the hedging instrument and the hedged item. Generally, the benchmark rate being hedged and the fixed rate on the hedging swap will match if the swap is "at-market" and executed at the inception of the hedging relationship.

5. **Adding last-of-layer/portfolio layer method for fair value hedges –** We propose adding last-of-layer/portfolio layer method for fair value hedges because it better aligns hedge accounting with companies' risk management strategies for managing interest rate risk and brings consistency between U.S. GAAP and statutory accounting. Last-of-layer allows entities to designate as the hedged item the last dollar amount of a closed portfolio of prepayable financial assets, or one or more beneficial interests in a portfolio of pre-payable financial instruments. When using this approach, it is assumed that as prepayments occur, they are first applied to the portion of the closed portfolio that are not part of the designated layer. At inception and on each assessment date, the entity would need to determine that the designated layer is expected to be outstanding until the end of the hedge. This approach simplifies the rigid nature of the similar asset test required for portfolio hedging for fair value hedges by allowing the ability to assess qualitatively instead of quantitatively by combining the partial-term fair value hedge election and the election to measure changes in the hedged item by using the benchmark rate component of the contractual coupon cash flows. This makes achieving hedge accounting for a portfolio of prepayable fixed rate assets easier. The similar asset test requirement for portfolio hedges often makes it difficult, if not impossible, for a group of disparate fixed-rate assets to qualify to be hedged on a portfolio basis. The FASB currently has tentative

conclusions for updates to last-of-layer method, so we will need a scope limitation to maintain consistency with GAAP. For example, last-of-layer would only be applicable to closed portfolios of assets, and companies would be prohibited from designating closed portfolios of liabilities.

6. **Adding hedges of interest rate risk when the hedged item can be settled before scheduled maturity –** We propose adding the ability to elect to only consider how changes in the benchmark rate affects the decision to prepay the instrument when it assesses hedge effectiveness and measures the change in the hedged item's value attributable to the hedged risk because it better aligns hedge accounting with companies' risk management strategies and brings consistency between U.S. GAAP and statutory accounting. If an entity makes this election, it does not consider how other factors (e.g. credit risk) might affect the decision to prepay the financial instrument.

Ref #2021-21: Related Party Reporting

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 25 and SSAP No. 43R, as illustrated in the proposal, to clarify application of the existing affiliate definition and incorporate disclosure requirements for all investments that involve related parties, regardless of whether or not they meet the affiliate definition ("the Related Party Exposure"). In addition, draft annual statement reporting revisions were also exposed, in anticipation of incorporating those revisions into a Blanks (E) Working Group proposal.

Interested parties appreciate NAIC staff meeting with industry to better understand the regulatory concerns and intent of this proposal.

The Related Party Exposure has the following two main goals:

1. Clarify the reporting of affiliate transactions within existing reporting lines in the investment schedules. This clarification intends to be consistent with the definition of an "affiliate" pursuant to the *Insurance Holding Company System Regulatory Act* (Model #440), *SSAP No. 25—Affiliates and Other Related Parties* and *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated (SCA) Entities*.

2. Incorporate new reporting requirements for investment transactions with related parties. Pursuant to recent discussions, regulators desire additional information on investment transactions involving related parties, regardless of whether the related party is "affiliated" pursuant to Model #440. To preserve the affiliate definition and reporting categories, these additional proposed reporting elements will be captured outside of the current affiliate reporting requirements.

To accomplish these goals, the Related Party Exposure proposes to make changes to SSAP No 25 - Affiliates and Other Related Parties and SSAP No. 43R - Loan-backed and Structured Securities. We understand that one of the goals of the proposal is to identify investments that are originated, managed, sponsored or serviced (referred to as managed by affiliates for the remainder of this letter) by an affiliate or related party of the insurer. Interested parties agree that this information can be useful for the regulators, but we believe that it is critical to differentiate investments where there is direct credit exposure to an affiliate from those investments that are only managed by affiliates with no underlying credit exposure to the affiliate or related parties of the insurer. The affiliate reporting distinction is very important for a number of reasons, including but not limited to the following:

a. ***Rating Agencies*** **–** Interested parties understand that the rating agencies may apply a higher risk factor to affiliated assets as there is a presumption that anything reported as affiliated has credit risk exposure to an SCA of the insurer.

b. ***NAIC Designations*** **–** Affiliated debt investments where there is credit exposure to an SCA of the insurer have to be filed with the SVO to obtain an NAIC designation. Affiliated equity investments in SCAs reported on Schedule D also require filing to confirm their reporting value on Schedule D. Debt investments in CLOs/CDOs that are managed by affiliates but that do not have any credit exposure to an affiliate are filing exempt because they are not deemed affiliated.

Our comments to the proposed changes to SSAP No. 25 and SSAP No. 43 are provided below:

1. ***Removal of references to U.S. GAAP guidance from SSAP No. 25*** - Interested parties agree with removing the U.S. GAAP reference to FASB Interpretation No. 35 as we agree that the statutory guidance uses a different threshold than US GAAP to determine if significant influence exists over an investee. In addition, the SSAP No. 25 guidance already includes a number of scenarios to rebut the presumption of control, which are similar to the examples provided in the GAAP guidance.

2. ***The Working Group's Proposed changes to SSAP No. 25 to add the following new paragraph:***

   "For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25."

   We understand from conversations with staff that this paragraph is meant to clarify the guidance in paragraph 7 of SSAP No. 25 and paragraph 6 of SSAP No. 97- Investments in Subsidiary, Controlled and Affiliated Entities. That guidance requires that investments in limited partnerships and other similar entities (i.e. investment funds) that are managed by a general partner that is affiliated to the insurer and where the insurer owns more than 10% of the investment fund's equity be reported as affiliated investments.

Interested parties understand that the current SSAP No. 25 and SSAP No. 97 guidance already require equity investments in limited partnerships and similar entities to be reported as affiliated if the insurer owns more than 10% of the equity of the limited partnership and the insurer is affiliated to the general partner or managing member for limited liability company structures. One thing to note is that even if the insurer is affiliated to the general partner, the insurer would usually not have any credit exposure to its affiliates in these structures as the underlying assets of the investment fund are usually held with unrelated parties. For this reason, interested parties note that there is a diversity in practice in the reporting of these investment funds on Schedule BA, with some insurers reporting these investments in the affiliated section of Schedule BA and others reporting these investments as unaffiliated. If the intent is to report these types of equity investments as affiliated when the presumption of control cannot be overcome, this will require some reporting changes by some insurers.

In regard to debt investments in investment funds or securitization vehicles managed by the insurer affiliates or related parties as well as mortgage loans managed by affiliates, we note that most insurers currently report those investments as unaffiliated on Schedule D, Schedule BA and Schedule B if there is no underlying credit exposure to affiliates of the insurer. Interested parties would like to highlight again that just because the insurer is affiliated with the manager or servicer of an investment vehicle such as a securitization, if the underlying assets in the structure do not have affiliated credit exposure, the investment itself should not be reported as affiliated as that would not be accurate reporting. See further comments on the SSAP No. 43R proposed changes in item No. 4 below.

The new proposed paragraph also includes a look-through requirement of these investment funds to identify instances where the investment fund owns more than 10% of the common stock of its underlying investees. Interested parties have concerns with this look-through review. Doing a look-through of the underlying investments of investment funds managed by affiliates of the insurer could potentially create a very significant operational burden that may have little or no benefit. The reason why there is potentially little benefit to this is because if these investment funds have purchased an equity investment that represents more than 10% but less than 50% of the voting stock of one of their investees, this would almost never give control to the investment fund. For most entities capitalized with common stock (i.e. voting entities), the parties that control are the ones that own more than 50% of the voting shares. If the Working Group feels that this look-through is necessary, interested parties will need time to get this process implemented. Interested parties believe that the earliest this look-through requirement can be implemented is for year-end 2023 as time will be needed to set up a process with all affiliated funds so that the funds provide a listing of underlying equity investments in other entities along with the percentage ownership. In addition, we suggest some wording changes, as shown below in the underlined text to the new paragraph, to link the new paragraph back to the examples in paragraph 7 to incorporate the examples of when the presumption of control can be overcome:

"For entities not controlled by voting interests, such as limited partnerships, trusts and other special purpose entities, control may be held by a general partner, servicer, or by other arrangements. The ability of the reporting entity or its affiliates to direct the management and policies of an entity through such arrangements shall constitute control as defined in paragraph 6. Additionally, a reporting entity or its affiliates may have indirect control of other entities through such arrangements. For example, if a limited partnership were to be controlled by an affiliated general partner, and that limited partnership held greater than 10% of the voting interests of another company, indirect control shall be presumed to exist <u>unless the presumption of control can be overcome as detailed in paragraph 7</u>. If direct or indirect control exists, whether through voting securities, contracts, common management or otherwise, the arrangement is considered affiliated under paragraph 5. Consistent with paragraph 8, a disclaimer of affiliation does not eliminate a "related party" distinction or disclosure requirements for material transactions pursuant to SSAP No. 25."

Interested parties also ask for clarification regarding what the implications are of identifying an underlying investee of an investment fund as an affiliate. We believe that any other transactions carried out with the indirect affiliate need to be disclosed in the related party footnote, but we are unclear as to the impacts to Schedule Y and any other reporting schedules. The unit of account in this case would be the direct investment in the affiliated investment fund, not the underlying investments of the investment fund. It is not clear to us whether the indirect affiliates would also need to be reported on Schedule Y and/or any other reporting schedules.

3. ***Proposed changes under paragraph 6 (a) of SSAP No. 43R regarding insurers' investments in securitization vehicles where the underlying assets of the securitization predominantly relate to assets with credit exposure to affiliates/related parties of the insurer*** – Interested parties agree that when the insurer has credit exposure to its SCAs, even if there are intermediaries as part of the transaction, such investment should be reported as affiliated in the investment schedules.

4. ***Proposed changes to SSAP No. 43R to clarify that investments managed by affiliates are viewed as affiliated even if the underlying assets in the structure do not have any credit exposure to an affiliate*** - Many insurers own asset management subsidiaries which manage securitization transactions. There is no question that the asset manager itself is an SCA of the insurer and such asset managers are reported on Schedule Y as affiliates of the insurer. However, when any debt tranches purchased from those securitization vehicles do not have any credit exposure to SCAs of the insurer, the debt tranches are not reported in the affiliated section of Schedule D even if the securitization vehicle is managed by an affiliate.

It is very important to interested parties that this distinction is understood for Schedule D bond investments. Schedule D bond investments should not be reported as affiliated if they do not have credit exposure to SCAs of the insurer.

We understand from conversations with NAIC staff that this clarification is not intended to change the reporting lines in which investments are currently reported. The expectation is that these investments will now have a new code that will identify these investments as being managed by a related party of the of the insurer but have no credit exposures to related parties.

Interested parties agree with adding new codes to differentiate investments that are simply managed by a related party (including SCAs) from those that in fact have credit exposure to a related party (including SCAs) of the insurer. See further comments to the proposed codes in item 5 below.

5. ***Proposed annual statement changes to add a new electronic-only column to the investment schedules to identify investments involving related parties*** – Interested Parties have no objection to the proposed new codes to specify the type of relationship with the manager/sponsor/servicer of an investment vehicle. However, we offer the following comments to provide better clarity as to the applicability of the codes:

    a. Most if not all of an insurer's general account investments are managed by an affiliated asset manager. The affiliated asset manager makes decisions as to when to buy and sell a specific investment, including reviewing the investment for potential credit losses. We do not believe that it is the intent of the proposal to flag all investments as affiliated only because an affiliated asset manager makes investment decisions over the investment. Insurers already report their relationship with affiliated asset managers in the related party footnote. We believe that the intent of this proposal is to identify investment vehicles that are managed by related parties (including SCAs) as well as investments with direct exposure to related parties (including SCAs) of the insurer. To that end, we believe the codes would predominantly apply to the following types of investments:

        i. CLOs/CDOs or special purpose entities set up to create a securitization vehicle that are managed by related parties (including SCAs) of the insurer.

        ii. Mutual funds/ETFs and other similar funds where the asset manager is a related party of the insurers (including SCAs of the insurer).

        iii. Limited partnerships, limited liability companies or trusts set up as investment vehicles where the general partner or managing member is a related party of the insurer (including SCAs of the insurer).

        iv. Debt and equity investments in affiliates where there is direct credit risk exposure to a related party (including SCAs of the insurer).

b. Codes 2, 3 and 4 of the Related Party Exposure refer to "securitizations and other similar investments" which may imply to some that the codes only apply to Schedule D assets since Schedule D is where debt investments in securitizations are reported. If the codes are expected to apply to all investment vehicles, perhaps the wording can be made clearer by saying "securitizations and other investment vehicles such as mutual funds, limited partnerships and limited liability companies."

Ref #2021-22: Schedule D-6-1, Supplemental Reporting

The Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal which would supplement the reporting of SCA investments reported in Schedule D-6-1, as illustrated in the proposal. The supplemental electronic data to be captured is consistent with current requirements in SSAP No. 97 and as a result, the agenda item did not propose statutory accounting revisions.

Interested parties have the following observations regarding this proposal:

- The nature of the NAIC valuation adjustments can be broad and include a range of possibilities. But in looking back to the reductions from the 2020 filings, there are notes for items such as: going concern, lack of audit, audit not provided in English, lack of a U.S. GAAP reconciliation, or other errors, etc. It appears that the most prevalent, by far, is a reduction to match the equity reflected in the audit.

- The adjustment is not intended to match the approved amount, but to adjust subsequent valuations to reflect the current equity that factors in the noted adjustment / issue by NAIC staff from the filing submission. For example, if an insurer didn't adjust for a surplus note, and staff adjusted their approved year end value to remove the surplus note, the insurer should make sure that a similar adjustment is reflected going forward when reporting the current equity amount.

- In addition, since this is gathering prior year information, we note that regulators will be able to easily identify significant swings in equity values for any particular SCA.

In summary, interested parties recommend that there be a formal process for communicating the adjustment to the state of domicile and a clearly articulated instruction for how the adjustment is to be reported to ensure that the adjustments are communicated to insurers by the state of domicile and that insurers clearly understand how the adjustments are to be reflected.

Ref #2021-23: SSAP No. 43R – Financial Modeling – Updated Guidance

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed two options for possible revision, as illustrated in the proposal, to update the summarized financial modeling guidance in SSAP No. 43R. The first option will retain existing guidance, with updates to reflect Valuation of Securities (E) Task Force adopted edits. The second option removes the summarized financial modeling guidance and refers users to the Purposes and Procedures Manual of the NAIC Investment Analysis Office, which is the source document for financial modeling guidance.

Interested parties support option one as presented in the exposure. While there are advantages and disadvantages to each option, option 1 provides meaningful holistic view of how these securities are treated in one spot, and without reference to the P&P manual, which we believe will be useful for financial and annual statement preparers. Interested parties note the following grammatical error in paragraph 27 a – third sentence (tracked changed suggestion):

> *"For a modeled non-legacy security, meaning one which closed after December 31, 2012, the NAIC designation and NAIC designation category assigned by the NAIC Securities Valuation Office must be used."*

Ref #2021-24: General Interrogatory for Cryptocurrencies

The Working Group moved this item to the active listing and exposed proposed revisions to be incorporated into a Blanks (E) Working Group proposal to add a new general interrogatory to the annual blanks, requiring disclosure of when cryptocurrencies are directly held or permitted for the remittance of premiums. This agenda item did not propose statutory revisions.

Interested parties have no comment on this item.

Ref #2021-25: Leasehold Improvements After Lease Termination

NAIC staff received a question about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term and noted that there is no explicit guidance for these situations in SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements nor SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities. In these scenarios, it was identified that the reporting entity had acquired the property that was initially subject to a lease; however regardless of the scenario, amortization of leasehold improvements is only permitted over the shorter of the estimated useful life of the improvement or the lease term (as defined in SSAP No. 22R). In a normal lease termination, one where the lessee does not acquire said property, any remaining leasehold improvements shall be immediately expensed. This agenda item has been drafted to clarify this guidance, to eliminate future questions and ensure consistent application.

Interested parties agree that, in most cases, unamortized lessee owned leasehold improvements should be immediately expensed if the lease is terminated. However, in the situation where the reporting entity purchases a property that it was previously leasing, the immediate expensing may not be appropriate in all circumstances.

SSAP No. 19, Furniture, Fixtures, Equipment and Leasehold Improvements, paragraph 4 defines leasehold improvements as (bolded for emphasis) "**lessee expenditures that are permanently attached to an asset** that a reporting entity is leasing under an operating lease."

In defining this issue, NAIC Staff referred to paragraphs 18 and 31 of SSAP No. 40R, Real Estate Investments, which relate to the sale of real estate. Within the guidance of these paragraphs, it is emphasized by Staff that the sale of real estate includes property improvements or integral equipment, which are defined as any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Interested parties agree if a reporting entity sells real estate, the asset, including property improvements and integral equipment, should be derecognized and a gain or loss on the sale be realized. However, as noted above, this issue relates to when a reporting entity acquires, not sells, a property that it was leasing.

SSAP No. 40R paragraph 8 states (bolded for emphasis), "The cost of real estate represents the fair value of the consideration exchanged plus any costs incurred to place the real estate asset in usable condition, including but not limited to, brokerage fees, legal fees, demolition, clearing and grading, fees of architects and engineers, **any additional expenditures made for equipment and fixtures that are made a permanent part of the structure**…" Therefore, under SSAP No. 40R, leasehold improvements are admitted assets.

The proposed revisions to SSAP No. 19 and SSAP No. 73 both state (**bolded for emphasis; *italics to denote reference to the appropriate party acquiring the leased real estate***):

> The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. **This includes situations in which leased real estate is acquired by the reporting entity (*lessee*) ~~lessor~~. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—*Real Estate Investments*.**

It is noted in the Staff Recommendation that "[i]t is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price." Under this presumption it is logical that the previously recognized leasehold improvements should be immediately expensed, otherwise, the reporting entity would be double counting the assets and related expense. In practice, however, interested parties generally believe this to be an unlikely scenario.

Lease agreements with purchase options can be complex and structured in a myriad of ways depending on how the reporting entity lessee negotiated with the lessor. There may be circumstances that the reporting entity negotiates a reduced price to acquire the real estate formerly leased to compensate for the permanent improvements it previously made. In other situations, the sales price is determined based on the then current fair or appraised value. In this situation, the lessee and lessor will engage a third-party appraiser to establish the sales price. Appraisers generally use the cost, sales comparison, or income approaches to establish the value. Generally, those approaches may not contemplate the specific lessee owned leasehold improvements unless those improvements generate material utility (e.g., expansion of the building itself, or in a ground lease, land improvements or a constructed building, etc.). Accordingly, the reporting entity would not be including in the cost of the acquired real estate any additional expenditures made for equipment and fixtures that are made a permanent part of the structure as required/allowed by SSAP No. 40R if the amendments to SSAP No. 19 and 73 require them to be written off at acquisition.

Additionally, interested parties believe it would generally be economically punitive to a reporting entity to provide consideration to purchase a leased asset to the landlord (seller) that includes significant costs that the reporting entity lessee already incurred for the leasehold improvements. Also, many States require material purchases of real estate (particularly for HMOs) to be approved by the Department of Insurance. Barring any unique circumstances, it is unlikely a regulator would approve a transaction that requires the reporting entity to pay additional amounts to a lessor for costs its already incurred.

Interested parties are also concerned with the additional complexity the exposure draft will add in applying SSAP No 22R versus ASC 842 for GAAP. As it stands today, there is already a cost basis difference between GAAP and SAP when purchasing the underlying leased asset. SSAP No 22R implies that any deferred rent liability upon termination of a lease would be adjusted off to the P&L (i.e., a gain). For GAAP under ASC 842, any remaining lease liability upon purchase of the leased asset is adjusted to the cost basis of the asset (i.e., effectively deferring the gain) along with the unamortized portion of the lessee owned leasehold improvements. Expensing unamortized leasehold improvements in all circumstances for terminated leases for SAP creates further cost basis differences that will artificially and significantly distort earnings and will be extremely difficult to operationalize.

It is also worth noting that for some interested parties, external auditors and regulators have audited these transactions and have been comfortable that duplication is not occurring.

Interested parties suggest that the following amendments be revised guidance of SSAP No. 19 and 73:

> The amortization of leasehold improvements (including property improvements and integral equipment) shall cease, with any remaining amount immediately expensed, in ~~**any**~~ event**<u>s</u>** in which the lease is terminated in advance of the lease term. **<u>When leased real estate is purchased by the reporting entity lessee resulting in termination of the lease, any unamortized lessee owned leasehold improvements should be added to the cost basis of the acquired real estate and recognized in accordance with SSAP No. 40R – Real Estate Investments. Any unamortized leasehold improvements owned by the reporting entity lessee that have no future economic benefit upon purchase of the leased real estate asset or those included in the purchase price of the acquired real estate should be immediately expensed.</u>** ~~**This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R – Real Estate Investments.**~~

Ref #2021-26EP: Editorial and Maintenance Update

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to certain, remaining terminology references of "substantive" and "nonsubstantive,"

In response to an Aug. 14 referral from the Financial Condition (E) Committee, the edits are proposed to update the terminology references of "substantive" and "nonsubstantive," which have historically been used to describe statutory accounting revisions being considered by the Working Group to the NAIC Accounting Practices & Procedures Manual. The Committee recommended terminology updates to alleviate concerns that users who are not familiar with the historical definitions of these terms may incorrectly perceive that the terms reflect potential financial impact rather than their intended definitions.

Accordingly, where applicable, the current concept/term of:

1) a "substantive" revision is proposed to be replaced with the phraseology of a "New SAP or New SAP concept in an existing SSAP," and,
2) a "nonsubstantive" revision is proposed to be replaced with the phraseology of a "SAP clarification."

Interested parties agree that the distinction between substantive (proposed to change to "development of new SSAPs or New SAP Concepts in an Existing SSAPs") and non-substantive (proposed to change to "Development of SAP Clarifications") can be confusing and that there would be more clarity in the development process if the distinction were eliminated.

Instead, we recommend that all new standards be handled similarly but that the effective date for each new standard be determined by evaluating the complexity of implementation (e.g., the extent that systems or process changes are required) and the availability of data to insurers to implement the new standard. This determination would be made as guidance is completed and with feedback from industry as to the time needed to adopt proposed reporting and/or disclosure.

Ref #2021-27: ***ASU 2021-04 - Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions, as illustrated in the proposal, to incorporate guidance related to the accounting for the changes in fair value when exchanging equity-classified written call options, while rejecting the remainder of ASU 2021-04 in SSAP No. 72.

Interested parties have no comment on the approach taken in the exposed revisions but recommend that the revisions be expanded to provide more detail to clarify what guidance from GAAP is adopted and what is not (similar to the description generally provided in an SSAP).

Ref #2021-28: ***ASU 2021-03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events***

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 68—Business Combinations and Goodwill to reject ASU 2021-

03, Intangibles – Goodwill and Other (Topic 350) – Accounting Alternative for Evaluating Triggering Events for statutory accounting.

Interested parties have no comment on this item.

Ref #2021-29: ***ASU 2021-05 - Leases (Topic 842), Lessors—Certain Leases with Variable Lease Payments***

The Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to reject ASU 2021-05 in SSAP No. 22R.

Interested parties have no comment on this item.

Ref #2021-30: ***ASU 2021-06—Amendments to SEC Paragraphs in Topic 205, Topic 942 and Topic 946***

The Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to Appendix D—Nonapplicable GAAP Pronouncements to reject ASU 2021-06 as not applicable to statutory accounting.

Interested parties have no comment on this item.

* * *

Thank you for considering interested parties' comments. If you have any questions in the interim, please do not hesitate to contact us.

Sincerely,

D. Keith Bell Rose Albrizio

cc: NAIC staff
Interested parties

APPENDIX

Suggested Modification to SSAP 86 for Discussions Related to FX Hedging / Excluded Components

Proposed Modifications to the Main Body of SSAP No. 86

40. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. If an entity's defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedged derivative from the assessment of hedged effectiveness (as discussed in Exhibit B), that excluded component of the gain or loss shall be recognized in accordance with Appendix C. ~~as an unrealized gain or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option's intrinsic value, the changes in the option's time value would be recognized in unrealized gain or losses. Time value is equal to the fair value of the option less its intrinsic value.~~

Proposed Modifications to Exhibit B

2. In defining how hedge effectiveness will be assessed, an entity must specify whether it will include in that assessment all of the gain or loss on a hedging instrument. As discussed in paragraph 33, this statement permits (but does not require) an entity to exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows:

a. If the effectiveness of a hedge with an option contract is assessed based on changes in the option's intrinsic value, the change in the time value of the contract would be excluded from the assessment of hedge effectiveness.

b. If the effectiveness of a hedge with an option contract is assessed based on changes in the option's minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract would be excluded from the assessment of hedge effectiveness.

c. If the effectiveness of a hedge with a forward or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price would be excluded from the assessment of hedge effectiveness.

d. If the effectiveness of a hedge with a foreign currency swap is assessed based on changes in fair value attributable to changes in spot rates, only the change in value of the foreign currency notional amount due to fluctuations in spot prices would be included in the assessment of effectiveness.

In each circumstance above, changes in the excluded component would be recognized in accordance with Appendix C. ~~included in unrealized gains or losses.~~ As noted in paragraph 1 of this Exhibit, the effectiveness of similar hedges generally should be assessed similarly; that includes whether a component of the gain or loss on a derivative is excluded in assessing effectiveness. No other components of a gain or loss on the designated hedging instrument may be excluded from the assessment of hedge effectiveness.

Proposed Modifications to Exhibit C

2. Swaps, Collars, and Forwards (see also discussion to Introduction above)

b. Statement Value

iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used.

(a) For forward contracts, ~~T~~the foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract:

1) was entered into within a year of maturity; or
2) is a foreign currency swap. For foreign currency swaps, the equivalent of a forward contract's premium (discount) is the cross-currency basis spread, which is amortized into income through the foreign currency swap's periodic interest accruals.

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the derivative equals:

1) For forward contracts, the amortized (premium) discount plus the cumulative unrealized gains/(loss) on the contract.
2) For foreign currency swaps, the cumulative unrealized gains/(loss) on the contract. Amortization of the cross-currency basis spread is recorded on the balance sheet as ~~Receivables (Payable) for~~ Investment Income Due & Accrued or Other Liabilities, as a component of the foreign currency swap's periodic interest accrual.

The cumulative unrealized gain/(loss) equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened.

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

~~(g)~~ If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, the hedge relationship shall be discontinued and the derivative shall be recorded at fair value pursuant to paragraph 22~~. valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a~~A cumulative unrealized gain/loss (surplus adjustment) will be recognized equal to the difference between the carrying value of the derivative on the balance sheet (at the time of de-designation) and the fair value of the derivative (at the time of de-designation)~~notional amount or designated notional amount times the difference between the forward rate available for the remaining~~

~~maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.~~

Proposed changes to Reporting

Updated to SSAP 86.62.vi:

86.62.vi ~~net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness;~~

<u>The change in fair value of derivative components excluded from the assessment of effectiveness (pursuant to paragraph 2 in Exhibit B). These changes in fair value that occurred during the period and cumulatively over the life to date of the hedge relationship shall be disclosed by derivative type.</u>

Example disclosure

<u>Two examples to choose from - year to date or cumulative</u>

For the years ended December 31, 2021 and 2020 there were derivative fair value changes excluded from the assessment of hedge effectiveness of $3M and $5M, respectively, related to foreign exchange swaps and $6M and $13M, respectively, related to foreign currency forwards.

At December 31, 2021 and 2020 there were derivative fair value changes excluded from the assessment of hedge effectiveness of $8M and 10M, respectively, related to foreign exchange swaps and $4M and $10M, respectively, related to foreign currency forwards.

Proposed Schedule DB changes <u>for identifier:</u>

Add an "X" to the Code column 15 indicating the qualifying derivative has a difference between BACV and FV due to an excluded component.

Suggested Modification to SSAP 86 for Discussions Related to Alignment of Interest Rate Hedging with GAAP (Topic 815/ASU 2017-12)

Proposed Modifications to the Main Body of SSAP 86

26. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

d. The hedged item is specifically identified as either all or a specific portion <u>or partial term</u> of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion <u>or partial term</u> thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof) <u>or closed portfolio of assets where assumed layer is anticipated to be outstanding (or a specific portion thereof). For partial term one or more consecutive selected contractual cash flows where the hedged item begins when the first hedge cash flow begins to accrue and ends when the last hedged cash flow is due and payable, the assumed maturity of the hedged item occurs on the date in which the last hedged cash flow is due and payable;</u>

e. If similar assets or liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributed to the hedged risk for each individual item in a hedged portfolio must be expected to respond in generally proportionate manner to the overall change in the fair value of the aggregate portfolio to the hedged risk;

f. <u>For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, an entity may designate as the hedged item a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows if the designation is made in conjunction with the partial-term hedging election in paragraph (this designation is referred to throughout as the "last-of-layer method" or "portfolio layer method").</u>

<u>a. For last-of-layer, an analysis shall be completed and documented to support the entity's expectation that the hedged item (that is, the designated last of layer) is anticipated to be outstanding as of the hedged item's assumed maturity date in accordance with the entity's partial-term hedge election. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets or beneficial interest(s) secured by a portfolio of prepayable financial instruments.</u>

<u>b. For purposes of its analysis, the entity may assume that as prepayments, defaults, and other events affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio of prepayable financial assets or one or more beneficial interests that is not part of the hedged item (that is, the designated last of layer);</u> and

g. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is:

i. The risk of changes in the overall fair value of the entire hedged item;

ii. The risk of changes in its fair value attributed to changes in benchmark interest rate risk;

iii. The risk of changes in its fair value attributed to change in the related foreign currency exchange rates; or

iv. The risk of changes in its fair value attributable to both change in the obligor's creditworthiness and changes in the spread over the benchmark interest rate with respect to the financial asset's or liability's credit sector at inception of the hedged (referred to as credit risk).

If the risk designated as being hedged is not the risk in paragraph 26.f.i, two or more of the other risks (benchmark interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedge relationship. In calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate, the estimated cash flows used in calculating fair value must be based on all of the contractual cash flows of the entire hedged item or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayable instrument. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how changes in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so). The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. ~~Excluding some of the hedged item's contractual cash flows (for example the portion of the interest rate coupon in excess of the benchmark interest rate) from the calculation is not permitted. An entity may not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a prepayable instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option must be considered in designating a hedge of benchmark interest rate risk.~~

Proposed Modifications to Exhibit B

8. Conditions applicable to fair value hedges only

f. The expiration date of the swaps matches the maturity date or assumed maturity date of the interest-bearing asset or liability.

g. There is no floor or cap on the variable interest rate of the swap

h. The interval between repricing of the variable interest in the swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).

i. For last-of-layer If both of the following conditions exist, the quantitative test described for similar asset test may be performed qualitatively and only at hedge inception:

a. The hedged item is a closed portfolio of prepayable financial assets or one or more beneficial interests.

b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.